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APR 9 1928
CHARLES ELMORE CROPL
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Supreme Court of the United States

OCTOBER TERM, 1927.

No. [redacted] 31

BOTANY WORSTED MILLS,
Petitioner,

vs.

THE UNITED STATES.

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

BRIEF FOR PETITIONER.

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PRINTED IN THE UNITED STATES BY C. G. BURGOYNE, INC., 107 LIBERTY STREET, NEW YORK

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SUPREME COURT OF THE UNITED STATES,

OCTOBER TERM, 1927.

No. 659.

BOTANY WORSTED MILLS,
Petitioner,

vs.

THE UNITED STATES.

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

BRIEF FOR PETITIONER.

The opinion of the Court of Claims has not yet been reported.

The judgment under review was entered April 4, 1927 (R. 26). The jurisdiction of this court is invoked under the Act of February 13, 1925, Sec. 3, paragraphs (b) and (c).

STATEMENT OF THE CASE.

The Question at Issue.

The question raised on this appeal is whether an oral "gentleman's agreement" compromising differences between the Bureau of Internal Revenue and a taxpayer, made by subordinate officials of the Bureau without securing the advice and consent of the Secretary of the Treasury required by the statute authorizing the compromise of tax cases, becomes, upon the filing of amended returns and payment of an additional assessment in ac-

cordance with the figures thus agreed upon, "in legal effect an executed contract of settlement" barring recovery of a part of the tax which was erroneously and illegally collected.

The Statutes.

The only statute in effect at the time in question, authorizing any compromise of tax cases, was Sec. 3229 of the Revised Statutes, which reads as follows:

> "The Commissioner of Internal Revenue, with the advice and consent of the Secretary of the Treasury, may compromise any civil or criminal case arising under the internal revenue laws instead of commencing suit thereon; and, with the advice and consent of the said Secretary and the recommendation of the Attorney General, he may compromise any such case after a suit thereon has been commenced. Whenever a compromise is made in any case there shall be placed on file in the office of the Commissioner the opinion of the Solicitor of Internal Revenue, or of the officer acting as such, with his reasons therefor, with a statement of the amount of tax assessed, the amount of additional tax or penalty imposed by law in consequence of the neglect or delinquency of the person against whom the tax is assessed, and the amount actually paid in accordance with the terms of the compromise."

The making of contracts on behalf of the United States except as authorized by law is prohibited under Sec. 3732 of the Revised Statutes, which reads as follows:

> "No contract or purchase on behalf of the United States shall be made, unless the same is authorized by law or is under an appropriation adequate to its fulfillment, except in the War and Navy Departments, for clothing, subsistence, forage, fuel, quarters, or transportation, which, however, shall not exceed the necessities of the current year."

The Facts.

Under a by-law which was originally adopted by the petitioner's stockholders in 1890 (R. 12) and, with slight modifications made by the stockholders, was in effect during 1917 (R. 13-15), the directors of petitioner, each of whom was an executive officer or manager of a department in the company (Finding XIV, R. 16), were entitled to receive compensation equal in the aggregate to 32% of the balance of the net profits of the company after certain deductions (Findings X, R. 14; see also R. 15.)

The net income of the company for 1917 was proportionately very large (R. 17). In its tax return for that year the company deducted as an expense the sum of $1,565,739.39 paid to its directors under such by-law (Finding III, R. 11).

Thereafter, in the year 1919, the Commissioner of Internal Revenue proposed making an additional assessment against petitioner for the year 1917. This necessitated the settlement of questions relating to the compensation paid to the directors and also to excessive depreciation charged off on the books of the company and reserves charged to expenses (Finding XIX, R. 18). After much correspondence and numerous conferences, extending over several months, in which the petitioner was represented by its attorney and assistant treasurer and others, and the Government by the chief of the special audit section of the Bureau of Internal Revenue and others of his official associates, "a compromise was agreed to as to all of the differences" (R. 19).

The compromise was based on the statement by the Bureau's representative that the amount of the compensation paid to the directors of the company for the year 1918 (while the company was controlled by the Alien Property Custodian, see R. 15) would be considered as a fair and reasonable amount for 1917 (R. 19). Accordingly, the Commissioner disallowed $783,656.06 of the deductions which had been taken for such compensation

in 1917 and allowed the balance "on the ground that the amounts paid as compensation were unreasonable, and that the deductions allowed represented fair and reasonable compensation" (Finding IV, R. 11). No concession is shown to have been made by the Bureau with reference to the other two questions involved relating to the 1917 taxes.

Thereafter the petitioner filed amended returns based on the figures as agreed upon in the conferences, together with documentary evidence which, at the last conference, it was agreed should be furnished, and the tax so computed, "with a slight change not material to this case" was paid by the petitioner. (Finding XIX, R. 20.) As a result of the disallowances made by the Commissioner, the petitioner was assessed and paid an additional tax of $703,578.37 for 1917, of which amount $450,994.06 was attributable to the disallowance of the said portion of the amount paid to the directors (Finding IV, R. 11). On February 1, 1922, the petitioner filed with the Commissioner of Internal Revenue a claim for refund of the said sum of $450,994.06. This was disallowed by the Commissioner on or about September 26, 1922 (Finding V, R. 12).

The Pleadings.

On September 12, 1924, the petitioner filed its petition in the Court of Claims of the United States asking judgment for the said amount of $450,994.06, with interest from June 28, 1920, allowable under Sections 1019 and 1020 of the Revenue Act of 1924 (R. 6 and 9).

The defendant entered no demurrer, plea, answer, counterclaim, setoff, claim of damages, demand, or defense and, consequently, a general traverse was entered as provided by Rule 34 of the Court of Claims (R. 9).

The Decision of the Court of Claims.

On the trial the Government interposed, under its general traverse, two defenses; first, "that the amount paid the directors for 1917 was unreasonable compensation; and, second, that in 1919 the various tax matters of plaintiff for 1917 were finally settled by compromise and mutual agreement." (Opinion R. 23.)

According to its opinion (no specific conclusions of law having been filed), the Court of Claims held that the directors' compensation "constituted one of 'the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties' " by the company and was therefore deductible (Revenue Act of 1916, Sec. 12(a)) (R. 23). It held also that, under that Act, the Commissioner of Internal Revenue, while having "the right to determine whether or not the amount paid the directors as compensation or salary was in fact something else, paid under the guise of salary," nevertheless "did not have authority to determine whether or not the compensation paid to its officers by a corporation was unreasonable compensation and to limit the deduction to what he might consider reasonable compensation." (R. 23, 24.) Inasmuch as "the Government has not claimed that any part of the payments to the directors was not compensation," the court, following the decision of the Circuit Court of Appeals of the 3d Circuit in *U. S.* v. *Philadelphia Knitting Mills Co.*, 273 Fed. 657, held with the petitioner on the main issue as to the illegality of the tax (R. 24).

The Court of Claims, however, denied petitioner any recovery on the basis of the second defense, holding, according to the opinion, that although "it is not claimed by the Government that plaintiff's taxes were settled under the provisions of section 3229" (R. 24), nevertheless "with the payment of the tax under the circumstances surrounding this case the agreement, which is mentioned in the record as a 'gentleman's agreement'

became in legal effect an executed contract of settlement" (R. 26).

Judgment accordingly was entered against the plaintiff on the 4th day of April, 1927 (R. 26). On May 17, 1927, plaintiff filed a motion for a new trial, which was denied, without opinion, on the 7th of November, 1927 (R. 26-27).

The petition for a writ of certiorari addressed to this court was granted on the 27th day of February, 1928.

SPECIFICATIONS OF ERROR.

Petitioner claims that the Court of Claims erred,

First, in holding that a contract of settlement could have been effected otherwise than with the advice and consent of the Secretary of the Treasury required by Section 3229 of the Revised Statutes; and

Second, in refusing to accord to petitioner the right to recover a tax erroneously or illegally collected which is granted by the provisions of the Revenue Act of 1924 which govern this action.

THE ARGUMENT.

POINT I.

The advice and consent of the Secretary of the Treasury was a necessary condition precedent to any valid compromise agreement between the Commissioner of Internal Revenue and a taxpayer.

A.

The only authority to enter into agreements compromising tax cases which had been given to the Commissioner of Internal Revenue at the time in question

(1919) was conferred by Sec. 3229 of the Revised Statutes, quoted above (p. 2).

It is conceded that the provisions of Section 3229 were not complied with (R. 24).

When Congress granted authority to the Commissioner to comprise tax cases under specific limitations, it negatived his authority to effect a compromise in any other way.

In *Raleigh Co.* v. *Reid,* 13 Wall. 269, this court said:

> "When a statute limits a thing to be done in a particular mode, it includes a negative of any other mode."

In the case of *Little et al.* v. *Barreme,* 2 Cranch. 170, an officer of the United States Navy, while the United States was at war with France, acting pursuant to instructions given under the authority of a proclamation by the President, captured the Danish brigantine, "Flying Fish". The owners thereafter claimed damages against the officer. He interposed as a defense the instructions he had received under the President's proclamation. The proclamation had been issued following the passage of an Act of Congress authorizing the seizure of American vessels suspected of being engaged in illicit commerce, bound, or sailing to any port or place in France. The proclamation had authorized the seizure of a vessel thus suspected, bound to or from French ports. The vessel in question had been coming from a French port.

Chief Justice Marshall, in writing for this court, said that, while it was "by no means clear that the President of the United States * * * might not without any especial authority for that purpose have authorized a seizure under the facts in question," nevertheless, inasmuch as the Act gives special authority to seize on the high seas, "and limits that authority to the seizure of vessels bound, or sailing to, a French port, the legislature seems to have prescribed that the manner in which

this law shall be carried into execution, was to exclude a seizure of any vessel not bound to a French port."

In *The United States* v. *George Jonas,* 19 Wall. 598, this court considered the effect of a statute which authorized the Solicitor of the Treasury to sell certain lands of the United States with the approval of the Secretary of the Treasury. The Solicitor, pursuant to an advertised sale, had tendered a deed to the highest bidder who refused to take it on the ground that there was no evidence that the consent and approval of the Secretary of the Treasury had been secured. This court held that the approval was "a thing essential to give validity to the sale" and "a condition precedent, without which the Solicitor has no authority whatever to act."

In the leading case of *The Floyd Acceptances,* 7 Wall. 666, this court said:

> "We have no officers in this government, from the President down to the most subordinate agent, who does not hold office under the law, with prescribed duties and limited authority."

The opinion referred "to the written law as the exclusive source of such authority."

In the instant case, the so-called compromise agreement, not having been authorized by law, falls within the specific prohibition of Sec. 3732 of the Revised Statutes (*supra* p. 2) and, accordingly, was null and void.

In *Whiteside* v. *U. S.,* 93 U. S. 247, a contract was attempted to be made pursuant to regulations issued by the Treasury Department under statutory authority. Such regulations required the approval of contracts of the kind in question by the supervising special agent. The contract under consideration, not having received such approval, this court said:

> "Tested by these several considerations, it is obvious that the conclusion of the court below, that the contract was incomplete because not approved

> by the supervising special agent, is correct. Beyond all doubt, it was made by the assistant special agent, who had no authority to make it; and it appearing that it never was approved by the supervising special agent, it follows that it was *null and void.*" (Italics ours.)

In *Filor* v. *U. S.*, 9 Wall. 45, this court considered a lease which had been made by an Assistant Quartermaster of a wharf that had been seized by the officers of the United States Army. It was found that, under the existing regulations, no lease could be binding upon the Government until approved by the Quartermaster General. Such approval had not been had. The court said:

> "The agreement or lease was, so far as the Government is concerned, the work of strangers."

In *Leach* v. *Nichols,* 23 Fed. (2d) Advance Sheets 275 (C. C. A. 1st Circuit) it was held that a compromise agreement made with the Internal Revenue Bureau without the advice and consent of the Secretary of the Treasury was not authorized, because failing to comply with R. S. Sec. 3229, and could not bar the taxpayer from maintaining an action in the courts.

B.

Under the then existing Treasury Regulations and in view of the established practice of the Internal Revenue Bureau, the "gentleman's agreement" must be construed as leaving it open to either party to take such further proceedings as might be authorized by law.

Article 38 of the Treasury Regulations relating to the Act of 1917 (Regs. No. 38 Revised), then in effect, provided that

> "Treasury decisions promulgating rulings of the Internal Revenue Bureau become effective upon the date of approval unless otherwise stated therein. Cases previously adjusted in contravention of

law as pronounced in such decisions, are subject to readjustment in accordance with the decision."

The transactions between the petitioner and the Internal Revenue Bureau were necessarily subject to this regulation. Under its provisions no adjustment could be made which might not be reopened in case of a subsequent change in ruling as to the law.

Commenting on the situation created by this regulation, the Senate Finance Committee, in reporting the Act of 1921 (see Senate Report 275 of Sep. 26, 1921, p. 31), stated with reference to the proposed Sec. 1312 thereof:

> "Section 1312 authorizes the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury and with the consent of the taxpayer, to reach a final settlement in tax cases which shall not be reopened or modified by any officer, employee, or agent of the United States, and which shall not be annulled or set aside by any court of the United States.
>
> "Under the present method of procedure a taxpayer never knows when he is through, as a tax case may be opened at any time because of a change in ruling by the Treasury Department. It is believed that this provision will tend to promote expedition in the handling of tax cases and certainty in tax adjustment. Your committee, therefore, recommends its adoption."

Sec. 1312 of the Act of 1921, referred to in such report, reads as follows:

> "Sec. 1312. *Final determinations and assessments.*—That if after a determination and assessment in any case the taxpayer has without protest paid in whole any tax or penalty, or accepted any abatement, credit, or refund based on such determination and assessment, and an agreement is made in writing between the taxpayer and the Commissioner, with the approval of the Secretary, that such determination and assessment shall be final and conclusive, then (except upon a showing of fraud or malfeasance or misrepresentation of

> fact materially affecting the determination or assessment thus made) (1) the case shall not be reopened or the determination and assessment modified by any officer, employee, or agent of the United States, and (2) no suit, action, or proceeding to annul, modify, or set aside such determination or assessment shall be entertained by any court of the United States."

The long continued practice of the Bureau and its own interpretation of the Commissioner's authority are evidenced by the following decisions of the Income Tax Unit and the Board of Tax Appeals:

In Cumulative Bulletin III-1 (January-June, 1924) at pages 338-339 is printed a ruling by the Income Tax Unit in which, after referring to the existing statutes relating to the powers of the Commissioner to make assessments, it is said:

> "Under the above sections of the law the Commissioner is specifically authorized to make inquiries, determinations, and assessments of taxes accruing under the various internal revenue laws. There is no provision of law which would prohibit the Commissioner from making reexaminations of income returns as often as he desires, unless he enters into a written agreement that the determination and assessment already made shall be final. The provisions of section 1312 specifically recognize that unless and until an agreement is made in writing between the Commissioner and the taxpayer closing the case it may be reexamined and the tax redetermined and additional assessments made as often as the Commissioner deems advisable within the prescribed time. If such was not the case, section 1312 would be unnecessary.
>
> * * * * * * * * *
>
> "This office has always taken the position that the Commissioner may assess any tax found to be due even though said tax may have previously been abated or refunded, provided such assessment is made within the time prescribed by statute. If there is a willful attempt to defeat or evade the

> tax, the assessment may be made at any time. Section 1322 of the Revenue Act of 1921."

In the case of *Dallas Brass & Copper Company,* Decision No. 1279, Board of Tax Appeals, (decided February 18, 1926) the taxpayer had made application for relief from certain assessments and the Commissioner had granted an abatement of the tax. Further application had been followed by numerous conferences, as a result of which the Commissioner allowed a further reduction which was embodied in writing. The amount as thus reduced was fully paid by the taxpayer. The decision was that the Commissioner was entirely free to reopen the case after the final payment, the opinion stating:

> "It has long been recognized, both by the Commissioner and all of his predecessors, as well as taxpayers generally, that reconsiderations of liability to internal revenue taxes were both proper and lawful."

That the views of the limitations upon its own authority finally to bind the Government which have been uniformly acted upon for years by the Bureau of Internal Revenue, should not be disregarded, is shown by the decision of this Court in *United States* v. *Finnell,* 185 U. S. 236, 244, where it is said:

> "If the construction thus acted upon by accounting officers for so many years should be overthrown, we apprehend that much confusion might arise. Of course, if the departmental construction of the statute in question were obviously or clearly wrong, it would be the duty of the court to so adjudge. *United States* v. *Graham,* 110 U. S. 219, 28 L. ed. 126, 3 Sup. Ct. Rep. 582; *Wisconsin C. R. Co.* v. *United States,* 164 U. S. 190, 41 L. ed. 399, 17 Sup. Ct. Rep. 45. But if there simply be doubt as to the soundness of that construction,—and that is the utmost that can be asserted by the government,—the action during many years of the Department charged with the execution of the statute should be respected, and not overruled except for cogent reasons. *Edwards* v.

Darby, 12 Wheat. 206, 210, 6 L. ed. 603, 604; *United States* v. *Philbrick*, 120 U. S. 52, 59, 30 L. ed. 559, 7 Sup. Ct. Rep. 413; *United States* v. *Johnston*, 124 U. S. 236, 253, 31 L. ed. 389, 8 Sup. Ct. Rep. 446; *United States* v. *Alabama G. S. R. Co.*, 142 U. S. 615, 621, 35 L. ed. 1134, 12 Sup. Ct. Rep. 306. Congress can enact such legislation as may be necessary to change the existing practice, if it deems that course conducive to the public interests."

C.

The opinion of the Court of Claims refers to a contention which had been advanced before it by the Government that the plaintiff "is estopped from recovery in this action" because it "received certain concessions as to other disputed items" (R. 25). The Solicitor General, however, in his brief on the petition for a writ, conceded that "no ground to claim estoppel is disclosed in the findings" (Brief for U. S. p. 11). Of this there can be no question.

The findings do not show that the plaintiff derived any benefits whatsoever in the alleged compromise other than the concession to it of an allowance of part of the directors' compensation, all of which should have been allowed. The inclusion in Finding XIX (R. 19 and see Opinion R. 25-26) of an excerpt from the minutes of plaintiff's board of directors is a finding of evidence, contrary to Rule 38 of this court, and may not be relied upon to support the decision. See *Norris* v. *Jackson*, 9 Wall. 125, *Raimond* v. *Terrebonne Parish*, 132 U. S. 192, 194 and *The E. A. Packer*, 140 U. S. 360, 365. Furthermore, it is obvious that, as a matter of logical inference, these minutes, which indicate a combined saving to the petitioner from additional assessments originally proposed for the three years, 1916, 1917 and 1918 (R. 19-20), do not throw any light whatsoever on how much of that saving was effected by the compromise of the 1917 taxes.

The only principle of estoppel which seems in any way to have been relied upon by the Court of Claims, according to its opinion, is that a party to a contract may not

seek to disaffirm it in part while affirming it in other respects (R. 26). This, of course, presupposes either the existence or the assertion of a contract. The petitioner has never in any way asserted the existence of a contract, but has denied it throughout.

Any defense of estoppel was waived because it was not pleaded. See *Gilmer* v. *Poindexter*, 10 Howard 257, 268, *Philadelphia W. & B. R. R. Co.* v. *Howard*, 13 Howard 307, 335; *Marbury* v. *Louisville & J. Ferry Co.*, 60 Fed. 645, 656; *Johnson* v. *Garner*, 233 Fed. 756, 773; *Feick* v. *Stephens*, 250 Fed. 185, 190 and *Krekeler* v. *Ritter*, 62 N. Y. 372, 374.

The transactions between the plaintiff and the Bureau of Internal Revenue could not have estopped one of the parties from pursuing any rights to question the validity of the tax granted it by statute unless they could have estopped the other. That the Government could not be estopped by the unauthorized actions of its agents is clear. See *Filor* v. *U. S.*, 9 Wall. 45, and *Utah Power and L. Co.* v. *U. S.*, 243 U. S. 389, 409. The principle stated by Judge Peckham in *Myers* v. *Cronk*, 113 N. Y. 608, 613, that "not being bound by any estoppel himself, he can claim the benefits of none, for it is familiar that estoppels, to be binding, must be mutual", applies here with full force.

POINT II.

Any right which the United States might once have had to set up the informal agreement and petitioner's action pursuant thereto as a bar to recovery was waived by the Revenue Act of 1924, under the provisions of which this action was brought.

Prior to 1924, the payment of the tax by the petitioner without protest and pursuant to the informal compromise might possibly have been construed as voluntary, thus barring an action for its recovery. (See *Fox* v. *Edwards*, 287 Fed. 669.)

This action was brought under Section 1014 of the Revenue Act of 1924 which reads as follows:

> "Sec. 1014. (a) Section 3226 of the Revised Statutes, is amended to read as follows:
>
> " 'Sec. 3226. No suit or proceeding shall be maintained in any court for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected until a claim for refund or credit has been duly filed with the Commissioner of Internal Revenue, according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof; *but such suit or proceeding may be maintained, whether or not such tax, penalty, or sum has been paid under protest or duress.* No such suit or proceeding shall be begun before the expiration of six months from the date of filing such claim unless the Commissioner renders a decision thereon within that time, nor after the expiration of five years from the date of the payment of such tax, penalty, or sum, unless such suit or proceeding is begun within two years after the disallowance of the part of such claim to which such suit or proceeding relates. The Commissioner shall within 90 days after any such disallowance notify the taxpayer thereof by mail.'
>
> "(b) This section shall not affect any proceeding in court instituted prior to the enactment of this Act". (Italics ours.)

Paragraph (b) makes it clear that the provisions of paragraph (a) apply to cases where court proceedings are instituted subsequent to the enactment of the Act, which was signed on June 2, 1924. This action was instituted September 12, 1924 (R. 6). Accordingly, the fact that the tax was paid without protest or duress can constitute no defense to the action.

To provide a method for finally determining a tax case without litigation, (See the Senate Report above quoted at p. 10), Sec. 1312 of the Act of 1921 was substantially reenacted in the following section of the 1924 Act:

> "Sec. 1006. If after a determination and assessment in any case the taxpayer has paid in whole any tax or penalty, or accepted any abatement, credit, or refund based on such determination and assessment, and an agreement is made in writing between the taxpayer and the Commissioner, with the approval of the Secretary, that such determination and assessment shall be final and conclusive, then (except upon a showing of fraud or malfeasance or misrepresentation of fact materially affecting the determination or assessment thus made) (1) the case shall not be reopened or the determination and assessment modified by any officer, employee, or agent of the United States, and (2) no suit, action, or proceeding to annul, modify, or set aside such determination or assessment shall be entertained by any court of the United States."

By these two Sections (1014 and 1006), Congress specifically decreed what conduct on the part of a taxpayer would debar him from recovering through the courts a tax illegally collected. A failure to file a claim for refund with the Commissioner of Internal Revenue, or to bring suit, within the times limited under Sec. 1014, or the making of an agreement as provided in Sec. 1006 would work such result. An agreement made in accordance with the provisions of Sec. 3229, Rev. Stat. (*supra* p. 2), which was not repealed by the Act of 1924, would also constitute a bar.

In this case there was a determination and an assessment paid in whole by the taxpayer based thereon, (Finding IV, R. 11) as specified in Sec. 1006; but there was no subsequent agreement as provided for therein. The expression in the statute of a particular form of

agreement as constituting a bar to an action in any court excludes any other kind of agreement from so operating.

Section 1006 gives protection to both the Government and the taxpayer. It would seem clear that Congress intended that no agreement made otherwise than as provided either by this section or by Sec. 3229 should preclude the Government from reopening a case or the taxpayer from bringing suit. If any such informal arrangement as was made in the instant case may become effective as a legally executed settlement contract, the efforts of Congress to safeguard the interests of the Government and the rights of taxpayers to appeal to the courts will be rendered nugatory.

POINT III.

If this court reverses the Court of Claims, the findings of that court are such as to justify the direction of a money judgment in behalf of the petitioner.

In the memorandum presented by the Solicitor General upon the petition for a writ herein, it was intimated that he might ultimately take the position that, in case of a reversal, the direction of a judgment for any stated sum is not justified by the findings. He pointed out two respects in which he considered the findings deficient, but in each case overlooked certain findings.

A. As to whether the payments to the directors were in fact compensation.

The Solicitor General stated that "in its opinion, but not in its findings the Court of Claims, said 'each director holds a position as an executive officer, or manager, of a certain department of the business'" (p. 14). This fact, however, is set forth in Finding XIV (R. 16).

The Solicitor General also overlooked the fact that Finding IV (R. 11) shows that the disallowance of a part of the directors' compensation was made by the Bureau "on the ground that the amounts paid as compensation were unreasonable."

He overlooked also, the fact, stated in the opinion that "the Government has not claimed that any part of the payment to the directors was not compensation, as claimed by plaintiff" (R. 24). The defense was only that it was "unreasonable compensation" (R. 23).

The findings that the compensation was paid in accordance with the by-laws of the company dating back to 1890 (Finding III, R. 11, Finding VII, R. 12, Finding X, R. 14) and with a custom prevailing in the industry (Finding XXII, R. 20), together with the finding that the only contract with any of the directors as to compensation was that implied from his election to and acceptance of membership on the board and his service as such member in accordance with the by-laws and practices of the company, which were known to each director (Finding XIV, R. 16), conclusively demonstrate that here was a contractual obligation, the payment of which, as stated by the court below in its opinion "constituted one of the 'ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties'" (R. 23). It was consequently deductible under Sec. 12 (a) of the Revenue Act of 1916 which provides for the deduction of

> "All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity."

It was not until the Revenue Act of 1918 that permissible deductions of amounts paid as salaries were limited to a "reasonable allowance" (see Revenue Act 1918, Sec. 234 (a) (1)).

All of the facts bearing on this aspect of the case were stipulated by the parties. While the stipulation is not in the record, we feel certain that the Solicitor General, in loyalty to it, will not again intimate to this court that there may be any question as to the fact that there was no relation between the amounts of stock held by the directors and the amounts they received as a percentage of profits.

B. As to possible offsets or counterclaims.

It should be noted that the Government, in its pleadings, as shown by the record before this court, did not assert any counterclaim, setoff or demand of any sort (R. 9).

In his memorandum on the petition for a writ herein, the Solicitor General, in two instances, misapprehended the findings relating to the concession made by the Government in the compromise. He asserted that "the items of depreciation and reserves claimed by the petitioner were allowed" (p. 7) and again that "the Bureau of Internal Revenue acquiesced in the petitioner's claims respecting depreciation and reserves for the same year, 1917" (p. 11). Neither of these statements has any support in the findings of the Court of Claims and neither is correct.

The only concession made to the petitioner in the compromise agreement shown by the findings was that involved in allowing approximately one-half of the deduction for directors' compensation.

We respectfully urge that unless the Solicitor General—after having made an examination of the facts

stipulated by the Government herein, which are not consistent with his suggestion that any concession other than as to directors' compensation was made by the Bureau in the compromise—will inform this court that, in case of reversal, the Government intends in good faith to interpose some definite offset in the court below, there is no reason why the petitioner should be subjected to the expense and delay of further court proceedings or why a judgment should not be directed for the sum of $450,994.06 with interest at 6% from June 28, 1920 as claimed in the petition (R. 9).

Respectfully submitted,

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